International Financial Reporting Standards and Earnings Management Behaviour of Listed Deposit Money Banks in Nigeria

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Abstract

This paper investigates the effect of International Financial Reporting Standards adoption on earnings management behavior of listed deposit money banks in Nigeria. The study examines how the change in the recognition and measurement of banks' loan loss provision, affects earnings management behaviour. A sample of 15 deposit money banks listed on the floor of the Nigerian Stock Exchange (NSE) was used. Financial data in respect of the periods before and after adoption of the IFRSs (i.e., 2004 to 2008 and 2009 to 2013) were used. The banks under investigation experience a significant growth of their loan portfolio, on average, 16.65 % (median 14.77 %) during IFRS period as compared to 10.12 % (8.79 %) before IFRS adoption. Non-performing loans (*NPLit-1*) remain relatively stable over the whole time period, and represent, on average, 3.44 % (median 2.21 %) of loans before and 3.19 % (median 1.99 %) after IFRS adoption. Regulatory capital ratios (*RegCap$_{it}$*) remain basically similar in both time periods. Earnings before taxes and loan loss provisions (*EBTLLP$_{it}$*) increase slightly; however, this increase is statistically not significant. Besides the impressive loan growth the most significant change between the two time periods relates to our dependent variable the level of loan loss provisions (*LLPit*). *LLPit* decreases significantly from a mean of 0.72 % (median 0.54 %) to 0.49 % (median 0.32 %) after IFRS adoption. Taken the descriptive statistics together, the study concludes that the restriction to incurred losses under IFRS significantly reduces the ability of banks to engage in earnings management.

Keywords: IFRS, IAS, financial reports, loan loss provisions, earnings management, non-performing loans, loss recognition, bank regulation, earnings before taxes and loan loss provisions.

1. Introduction

The internationalization of accounting standards by many countries, including Nigeria is set to significantly change companies' financial reports. Stakeholders have been united in the push towards a common set of international accounting standards. Expected benefits of internationalizing accounting standards include increased comparability and providing financial report users with better quality information on which to base their investment and credit decisions (AASB, 1994). These expectations implicitly assume that adoption of international accounting standards will lead to improvements in the quality of reported financial information. The quality of information provided in financial reports determines the usefulness and reliance of such reports to users. The characteristics by which quality can be measured are relevance, understandability and comparability. IFRSs are cut out to ensure that these characteristics are protected. The adoption of IFRSs presents an opportunity to banks in transforming their finance functions and creating more value for their banks by creating operational efficiencies (Accenture, 2009). The adoption of IFRSs has largely been supported by the fact that IFRSs are associated with greater accounting quality (Barth et. al. 2006; Barth et. al., 2008).

This paper examines the issues associated with the adoption of the IFRSs in relation to banks ability to embark on earnings management. The study seeks to find out whether the adoption of IFRSs presents an opportunity to banks in transforming their finance functions and creating more value for their banks by creating operational efficiencies through loan loss provisions. The applicable standard is IAS 39 Financial Instruments: Recognition and Measurement, although, IFRS 9 (Financial Instruments) is intended to replace IAS 39, the effective date is 1 January, 2018. IAS 39 (Financial Instruments: Recognition and Measurement) outlines the requirements for the recognition and measurement of financial assets and financial liabilities. Losses in the value of loans and advances are recognized and brought into the account based on incurred loss approach. There is a wide agreement among scholars that this is the major area managers may be motivated to carry out earnings management to shore up the firm's financial performance. Therefore, this paper examines the impact of IAS 39 on the accounting quality of financial reports of Nigerian deposit money banks.

The introduction of IFRS (IAS 39) represents a significant change in Nigerian deposit money banks' loan loss accounting as regards the recognition and measurement of credit risks. Unlike under the local GAAPs of Nigeria, the incurred loss approach of IAS 39 requires banks to provide only for incurred losses, but not for future expected losses. And given the importance of loan loss provisions in determining reported earnings of banks (Nichols et al., 2009), the paper expects changes in these – by their nature highly discretionary – accruals to have

significant aggregate effects on banks' earnings characteristics. Therefore, our paper examines how the transition to IFRS in Nigeria and particularly the switch to the incurred loss approach which underlies the recognition of loan losses, impacts financial reporting quality of Nigerian deposit money banks. The paper measures financial reporting quality in terms of earnings management. The following research question emanates directly from the aforementioned objective of the study: to what extent does the adoption of IAS 39 affects accounting quality of financial reports of Nigerian deposit money banks? Given the earnings management behaviour found in previous literature for a pre-IFRS period and the latter theoretical insights the paper posits the following hypothesis:
H: After IFRS adoption, Nigerian deposit money banks exhibit less earnings management behaviour.

2. Literature Review

Accounting standard setters set rules with the aim of providing decision useful information for general-purpose users of financial statements, in particular investors. They recognize that managers may have incentives to use loan loss provisioning to manipulate reported numbers. In some periods they may have an incentive to understate expected losses to boost net income or capital; in other periods they may have incentives to overstate current loan loss provisions when earnings are high which allows them to understate losses in future periods with lower earnings (Benston and Wall, 2005). Standards setters are worried about biased estimates in either direction which explains their choice to restrict loan loss provisioning to incurred losses. Earnings management through discretionary loan loss provisioning has been detected in several empirical studies, most of them analyzing foreign banks. The bulk of empirical studies tries to explain this behaviour by a variety of incentives, in particular earnings and capital management. The results across studies are not conclusive which might be attributable to differences in time periods analyzed and differences in research designs. Beatty et al. (1995) find evidence that banks manage their regulatory capital through the loan loss provision, but do not engage in earnings management.

In contrast, Collins et al. (1995) find no evidence for capital management, but report a positive correlation of earnings and loan loss provisions which is consistent with the earnings management hypothesis. These papers analyze a period before the implementation of the Basel I framework. Kim and Kross (1998) compare the pre-Basel I period with the Basel I period and find that due to changes in incentives banks with low capital ratios reduced their loan loss provisions after the implementation of Basel I. Similarly, Ahmed et al. (1999) revisit the above motivations for a more recent period after the change in capital adequacy regulations. They find evidence for capital management, but not for earnings management. Altamuro and Beatty (2010) analyze the financial reporting effects of the Federal Depository Insurance Corporation Improvement Act internal control provisions. They find that the change in internal control improves loan loss provision validity and reduces earnings management.

Recent empirical studies find that the extent of discretionary behaviour depends on accounting regime (Perez et al., 2008), the economic cycle (Laeven and Majnoni, 2003), investor protection, regulatory regimes, financial structure and financial development (Shen and Chih, 2005; Fonseca and Gonzalez, 2007). Motivations for discretion in financial reporting are diverse and can be explained partly by the fact that many implicit and explicit contracts of the bank refer to accounting numbers. Violation of these contracts (e.g. non-compliance with regulatory capital requirements) can affect the economic value of the bank (Beaver and Engel, 1996). The most common issues examined by this literature include accounting quality (Cascino and Gassen, 2010; Ahmed, *et al*. 1999; Christensen, *et al*. 2008; Capkun, *et al*. 2011; Lang, *et al*. 2010; Byard, *et al*. 2011; Tan, *et al*. 2009; Shahzad, 2010; DeFond, *et al*. 2011; Aharony, *et al*. 2010; Barth, *et al*. 2011; Wu and Zhang, 2009a; Landsman, *et al*. 2011; Beuselinck, *et al*. 2010; Li, 2010 and Daske, *et al*. 2008.

Bruggemann, *et al*. (2011) conduct a thorough review of this literature and conclude that the overall evidence is mixed. In comparing local standards to IFRS, some studies have shown that there are no significant differences in accounting results with the implication that the adoption of IFRS does not result in earnings management. Studies in Germany by Tendeloo and Vanstraelen (2005) and Hung and Subramanyam (2007) did find similarities in earnings management and value relevance in comparing results of the national and international standards. Accounting literature has operationalised accounting quality on the basis of earnings management, timely loss recognition and value relevance metrics. The higher disclosure requirements and financial reporting quality that stem from IFRS imply that the adoption of IFRS would give a positive signal to investors as information asymmetry and agency costs tend to diminish (Tarca, 2004). It appears, therefore, that corporations that adopt IFRS would tend to display lower potential for earnings management (Leuz and Verrecchia, 2000; Ashbaugh, 2001; Ashbaugh and Pincus, 2001; Leuz, 2003). Less subjectivity would lead to fewer opportunities to influence reported earnings and bonuses and/or mislead investors. Hence, in countries with strong investor protection mechanisms, such as the UK, the costs of IFRS adoption would tend to be lower because the level of

earnings management is lower as managers are less inclined to manipulate the reported accounting figures (Nenova, 2003; Dyck and Zingales, 2004; Renders and Gaeremynck, 2007). In contrast, in countries with weak investor protection mechanisms, the scope for earnings management would tend to be higher and the quality of financial reporting lower, implying that the costs of adopting IFRS would be higher (Ali and Hwang, 2000; Hung, 2001).

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Healy and Wahlen (1999) in a study titled, A Review of the Earnings Management Literature and Its Implications for Standard Setting, review the academic evidence on earnings management and its implications for accounting standard setters and regulators. They structure the review around questions likely to be of interest to standard setters. They review the empirical evidence on which specific accruals are used to manage earnings, the magnitude and frequency of any earnings management and whether earnings management affects resource allocation in the economy. The study also identifies a number of opportunities for future research on earnings management.

Leuz, *et al*. (2003) conclude that evidence was adduced to the effect that a large frequency of small positive earnings is an indication of managing towards positive earnings. The conclusion from this and other similar studies was that corporations applying IAS report small positive earnings with lower frequency. Negash (2003) reaches similar conclusion about the bid-ask spread data that was obtained from the Johannesburg Stock Exchange (JSE). Furthermore, the conclusion of Daske, *et al*. is unclear in another respect. For equity value to increase, the cost of capital should be lower in the post adoption period. The gospel of fundamental analysis states that value is nothing more than the present value of earnings discounted at cost of capital. Hence, to find an increased value but to find no clear result in cost of capital is an anomaly that warrants investigation. A related problem is on the use of the market to book ratio. As a result of the absence of replacement cost data, many studies use the market to book ratio to relate their work to Tobin's ideas. Evidently this is problematic. In this respect, Lev and Soungiannis (1999) show that the market to book ratio is indeed a "black box"; and it is common knowledge that fair value accounting has gradually and systematically diminished the gap between the net asset value per share and year-end share prices. From a policy perspective, as the study deals with economic consequences, the interesting question is not just showing aggregate gains (improvement in liquidity and value). The study needs to indicate the winners and losers of integration (liberalization and harmonization of financial information policy). The evidence from the literature is that the winners are largely big corporations that also carry lower debt. Whether the optimism about IFRS is confined to the beneficiaries of liberalization (big corporations, including global accounting/audit corporations) is a matter that needs a separate study.

Tendeloo and Vanstraelen (2005) in a study titled, Earnings Management under German GAAP versus IFRS, addresses the question whether voluntary adoption of IFRS is associated with lower earnings management compared to German companies reporting under German GAAP while controlling for other differences in earnings management incentives. A sample consisting of German listed companies contains 636 firm year observations relating to the period 1999 – 2001. The results suggest that IFRS adopters do not present different earnings management behavior compared to companies reporting under German GAAP. The findings contribute to the current debate on whether high quality standards are sufficient and effective in countries with weak investor protection rights. The results indicate that voluntary adopters of IFRS in Germany cannot be associated with lower earnings management.

Chalmers, Clinch and Godfrey (2007) conduct a single country study, and follow the value relevance theme to examine the association between year-end equity prices and accrual accounting information. It broadly followed the Ohlson (1995) and Begley and Feltham (2002) methodology to examine the effect of IAS adoption in South Africa. Wang, Young and Zhuang (2007), Armstrong, Barth, Jagolinzer and Riedl (2007), Prather-Kinsey,

Jermakowicz and Vongphanith (2007) examine stock market reaction to the elaborate bureaucracy that was involved in the adoption of IFRS in the European Union (EU). The result of their event study suggests that EU stock markets reacted positively to events that increased the likelihood of IFRS adoption. Wang, *et al.* (2007) work is similar to the works of Armstrong, *et al.* (2007) and Prather-Kinsey, *et al.* (2007). It has more procedural complexity. These studies, however, have no epistemological difference. The review below focuses on the study that followed more complex research procedures.

Wang, *et al.* (2007) examine the effects of mandatory IFRS adoption on analysts' information environment (as captured by analysts' forecast characteristics), and analysts' public information environment (as captured by information content of earnings announcements and its importance relative to the total information environment). They used a new methodology that purports to be an improved measure of the importance of quarterly earnings on equity returns, and concluded that mandatory IFRS adoption is significantly associated with reduced earnings forecast errors and increased abnormal return variance. The result suggests improvement in analysts' forecast and public information environments under IFRS. Furthermore, the adoption effects were greater for mandatory than for voluntary adopters. The adoption effects were also found to be different in each country. From an integration perspective, the study sends the message that IFRS has been a useful instrument.

Wang, *et al.* (2007) apply a set of procedures to examine analysts' forecast errors and analysts forecast errors dispersion. They compared the two variables across pre and post IFRS adoption periods. Furthermore, the information content of annual earnings and quarterly earnings were examined using a new measure that was developed by Ball and Shivakumar (2007/8). The new measure is the abnormal R^2, which is the difference between adjusted R^2 and expected R^2. However, it is important to note that Ball and Shivakumar develop the abnormal R^2 parameter by assuming that the null hypothesis that daily returns, including earnings announcement and window returns are identically and independently distributed across time. Therefore, two issues arise. First, Ball and Shivakumar are not the only researchers that reported the declining relevance of accounting earnings to stock returns. Second, from a methodology perspective, Wang, *et al.* did not examine whether Ball and Shivakumar's econometric assumptions are also valid for EU stock markets. Prior research has documented that different intervals had produced different betas (Hawawini, 1983). In other words, the distributional properties of EU returns were assumed to be the same as the returns on the New York Stock Exchange. Another concern that is related to the above is about the differences in the microstructures of the stock markets in the European Union. Given that the research merges and computes stock returns in each market, it is evident that one needs to control for differences in size and complexity of the stock markets that are included in the study. Furthermore, recent studies on capital structure in emerging economies indicate that care is needed in the interpretation of the control valuables.

Furthermore, cross sectional financial statement information might be affected by scaling differences, and it is unclear whether the authors have sought remedies. Analyst bias and optimism, issues which in turn are assumed to be causes of earnings management were not addressed. Similarly the quality and sustainability of reported earnings were not examined. Return generation and computation of analyst forecast errors suggest the existence of one market and one regulatory organization. The medium to long-term effects of IFRS adoption are not extricated in the normal return generation procedure and the accompanied statistical tests. Daske, *et al.* (2007a) examine what they believed to be proxies for the economic consequences of change in the quality of financial reporting (IFRS adoption) in 35 countries. The proxies for economic consequences were market liquidity, cost of equity capital and Tobin's Q ratio. Daske, *et al.* follow the Glosten and Milgrom (1985), Glosten and Harris (1988), Diamond and Verrecchia (1991) and Baiman and Verrecchia (1996) thread in analyzing the buy-sell spread data. The theoretical basis of this direction of disclosure research is however different from the familiar event study and information content studies that were discussed earlier. Information content studies tacitly assume a competitive and a somewhat information efficient stock market. In contrast, the analysis of bid-ask spread assumes the existence of a market maker. The market maker institutional setting suits the oligopoly type market structure that is found in several of the smaller EU stock markets. In this respect, Amihud, Mendelson, and Lauterbach, (1997); and Bruner, Conroy, Estrada, Kritzman and Li (2002) identify particular market microstructure issues that might also be relevant to smaller EU stock markets.

The econometric method used was panel data analytical method, with no control for differences in microstructures. The sample was classified into mandatory adopters, early voluntary adopters and late voluntary adopters. Daske, *et al.* examine the results of three regressions and mix of monthly stock market and financial statement data, concluded that in the post IFRS adoption period, liquidity and equity value increased while the result for cost of capital was mixed. The conclusion of the study raises few problems. First, total spread can be disaggregated. In this respect, George, Kaul and Nimalendrian (1991) decouple bid-ask (buy-sell) spread into

three components: information, order processing costs and inventory holding cost components, and stated that the information component of the spread is only about 8 to 11 percent of the total spread. If this is the case, the net gain (improvement in equity value) as a result of new or additional information is unlikely to be significant.

Wang, *et al.* (2007) computes stock returns, analyst forecast errors and accounting earnings, and follows the familiar event study methodology and cross sectional regression. Daske, *et al.* (2007a and 2007b) studies had the uncertainty-disclosure dimension. They examine the bid-ask spread and follow the Glosten and Milgrom, (1985); Diamond and Verrecchia, (1991); Baiman and Verrecchia, (1996) and Botosan, (1997) thread of disclosure research. They provide the early evidence about the IFRS adoption effect on 35 countries. Paananen (2008) reports no quality increases in the Swedish case. Landsman and Lang (2008) develop an accounting quality metrics that is composed of indicators for earnings management, accounting prudence (early recognition of losses) and value relevance to examine the IAS adoption effect. According to Cai, *et al.* (2008), in a study titled, the Effect of IFRS and its Enforcement on Earnings Management: An International Comparison, widespread adoption of IFRS is expected to improve accounting quality. They examine the effect of IFRS and its enforcement on earnings management in financial reporting using over 100,000 firm-year observations from 2000 to 2006 across 32 countries. They conduct this examination by using a modified measure of enforcement developed by Hope (2003). They find that earnings management in IFRS adoption countries has been decreasing in recent years. The results also show that countries with stronger enforcement generally have less earnings management.

Barth, *et al.* (2008) develop a comprehensive index for financial reporting quality. It is composed of: (a) earnings management (including earnings smoothing) indicators, (b) timely recognition of losses, and (c) value relevance of accrual accounting information. Barth, et al examine these indicators using cross country data, pooled regression, control variables and matched samples, in pre IAS adoption and post IAS adoption periods. The study concludes that IAS adoption has been associated with lower earnings management, more timely recognition of large losses and more association between equity prices and book value and earnings/returns.

Barth, *et al.* (2008) computed earnings management indicators as (1) variability of change in net income scaled by total assets, $\Delta NI/TA$; (2) the mean ratio of the variability of change in net income to the variability of change in operating cash flows, ΔCFO; $[\Delta NI/TA]/[\Delta CFO]$; (3) Spearman rank correlation between accruals and cash flows (not the modified Jones model), and (4) unlike the Burgstaller and Dechev (1997) and Dutrich and Easton (2004), the small positive increase in earnings and loss avoidance were captured by putting a dummy in a cross sectional regression (if net income scaled by total assets is between 0 and 0.01 and interpreting the signs of the regression coefficients in pre and post adoption periods).

However, Barth, *et al.* (2008) did not assign weight for each of the components of the accounting quality indicators. Furthermore, accounting quality was related to earnings management and earnings quality (proximity of accrual earnings to cash flows). It did not address issues related to the sustainability of reported earnings and unreported debt. The sample used in the study was 327, and came from 21 countries (of which about a third are members of the EU). The number of corporations adopting IAS reached maximum in 1999 and 2000 (just before the IFRS movement got strength in EU and IASB was created). Furthermore, three countries constituted 71.5% of their sample (China, 27.5%; Germany, 19.88% and Switzerland, 24.16%). Other than Switzerland no Francophone country was included in the sample. Similarly, the sample for United Kingdom was (1), Australia (1) and South Africa (8). That is, ten corporations represented the Anglophone world. However, IAS has had a long association between Britain and its former colonies (Commonwealth). Hence, the conclusion of the study depends on how one perceives its sampling difficulties. Furthermore, it is unclear how the difference in market microstructure has been addressed. Finally, the accounting quality metrics ignores important issues that are relevant to the sustainability of reported earnings. In other words the quality metrics does not explicitly address the heighted tension between reported earnings of specialized industries (example oil and gas, mining and extractive, transport, nuclear, pharmaceuticals, etc.) and the costs and liabilities associated with the rehabilitation and restoration of the environment.

Negash (2008) examines the IAS adoption effect on the Johannesburg Securities Exchange (JSE) listed corporations using a version of the Ohlson model (book value plus earnings and dividends), and applied a four year window period to examine the value relevance of accrual accounting information in pre liberalization (pre IAS adoption period of 1989-1993) and post IAS adoption period (1998-2004). The study had a liberalization (integration) perspective, and concluded that when scale effects were controlled the difference in panel regression R^2 vanished; suggesting that the value relevance of accounting information did not improve in the

post IAS adoption period. Furthermore, the results indicated that the relationship between year-end equity prices and accrual accounting variables could no longer be explained by linear models.

Aktaş (2009) relates data from balance sheet and income statement with the stock prices in Turkey. The study concluded that changes in net income, assets per share, book value per share, and liabilities per share are value relevant in calculating stock prices for the period of 1992-2007. Türel (2009) compares the value relevance of accounting information for the periods 2001-2002 and 2005-2006. The results showed that the value relevance of earnings and book value of equity has increased after adopting IFRS for the given period. Cooke, *et al*. (2009) examine the degree of long-run explanatory power of the book value of net assets for market value by investigating time series relations of five conglomerates in Japan for the period 1950-2004. Their results show that in four of the five firms there is evidence of a long-run relationship between market value and the net book value of assets.

Perera and Thrikawala (2010) find relations between market price per share and selected accounting information of commercial banks for 5 years in Sri Lanka. According to their findings, there is a relationship between accounting information and market price per share. Al-Horani's (2010) study shows that both univariate and multivariate analyses present no evidence of value relevance of earnings components for aggregate banks as using commercial banks data for the period 2000-2008 in Amman Stock Exchange. Glezakos, *et al*. (2012) related book value and earnings per share to share prices in Athens Stock Exchange for 38 firms. They presented that the value relevance of book value and earnings per share increased over time. Alali and Foote (2012) stated that earnings are positively related to cumulative returns and that earnings per share and book value per share are positively related to price per share in Abu Dhabi Stock Exchange.

In Turkey, value relevance of accounting information has also been analyzed in several perspectives. Kirkulak and Balsari (2009) analyze the effect of inflation-adjusted data on explaining the market value of equity and stock returns in Turkey. They reported that both historical cost-based book value and earnings information and inflation-adjusted information are value relevant and they complement each other, that is, using them together results to more value relevance. However, they also stated that comparing value relevance of inflation-adjusted information is a unique opportunity since firms reported their financial statements in both historical cost numbers and inflation-adjusted numbers only for the year 2003. Because of lower inflation rates and the implementation of international accounting standards since 2005, applying inflation accounting would not be needed (Gücenme and Poroy-Arsoy, 2006).

Iatridis (2010) focuses on the effects of switching UK GAAP to IFRS in the UK. The results show that implementations of IFRS generally reinforce accounting quality and lead more value relevant accounting measures. However study of Papadatos and Bellas (2011) indicate that relation between mandatory implementation of IFRS and value relevance of accounting information may not be in the same direction for every firm since they stated that both firm size and fixed assets became significant factors in their study. Dobija and Klimczak (2010) explore value relevance of accounting information in Polish market and find that market efficiency and value relevance did not noticeably improved after adoption of accounting standards while supporting harmonization process and foreign investment.

Elbannan (2011) reports mixed findings in Egypt. Khanagha (2011) examine the value relevance of accounting information in pre- and post-periods of IFRS implementation in United Arab Emirates (UAE). The results show that accounting information is value relevant in UAE stock market in general but the value relevance of accounting data decreased with IFRS application. It is also stated that cash flows' incremental information content increased in the post-IFRS period. Macías and Muiño (2011) examine accounting systems of countries some of which are full adopters and others are partial adopters of IFRS in Europe. They believed that accounting system serves the needs of capital providers in full adopter countries and it serves other purposes in partial adopter countries. Their results show that quality of accounting information improves with the full implementation of IFRS. Requiring the use of local standards in the preparation of legal entity financial statements presents lower level of accounting quality both prior to and after IFRS adoption.

Macías and Muiño (2011) state that adoption of IFRS in these countries are mostly for satisfying regulatory needs and not for satisfying investors' and creditors' needs. Van der Meulen, *et al*. (2007) investigated the attribute differences (value relevance and timeliness) between US GAAP and IFRS earnings. They found that US GAAP and IFRS only differ with regard to the predictive ability as US GAAP outperforms IFRS in given controlling differences. However, they did not observe significant and consistent differences for the value relevance attribute.

Verleun, *et al*. (2011) investigate the impact of the Sarbanes-Oxley (SOX) Act on the quality of financial statements in USA for technology and non-technology firms. They presented evidence that the enactment of SOX has had a positive effect on accounting quality. They stated that the value relevance of accounting information has also increased after SOX was enacted. Callao, *et al*. (2007) focus on IBEX-35 companies to see the effects of the new standards on comparability and relevance of financial reporting in Spain. Their results show that local comparability is adversely affected if both IFRS and local accounting standards are used in the same country at the same financial period. Because of worsened local comparability, Callao, *et al*. suggest an urgent transformation of local rules according to the international accounting standards. They also stated that even though value relevance of accounting information has not been significantly improved in the short run with the implementation of IFRS, it is expected to improve in the medium and long run.

Karampinis and Hevas (2011) investigate IFRS implementation and value relevance of accounting data. They explored potential effects of IFRS implementation on two salient properties of accounting income; value relevance and conditional conservatism. Their results show that only minor improvements have been observed related with selected properties of income. Karampinis and Hevas (2009) find similar results for value relevance of mandatory application of IFRS in Greece. They concluded that mandating IFRS may be beneficial for the selected period. Study of Iatridis and Rouvolis (2010) also provided that IFRS adoption leads to more value relevant accounting measures in Greece Stock Exchange for 254 firms. Iyoha and Jafaru (2011) in a study titled, Institutional Infrastructure and the Adoption of IFRS in Nigeria, find evidence of earnings management as part of efforts to avoid reporting losses by managers using the discretion in fair value accounting under the IFRS. However, they failed to compare and contrast the extent of overall earnings management before and after the mandatory IFRS adoption.

Mechelli and Cimini (2011) in a study titled, How Have the IAS/IFRS Adoption affected Earnings Management in EU: The Effect of the Absence/Divergence of Regulation and of Legal Enforcement, investigate the effect produced by the adoption of IAS/IFRS on earnings management in EU. The study established four indexes for the periods 2000-2003 and 2006-2009 to identify different reasons that could lead insiders to manipulate earnings and by comparing them the study observe that the IAS/IFRS first time adoption produced different effects on earnings management depending on the countries analyzed and the kind of earnings management investigated. The study find a positive relation between the reduction of earnings management and the extent to which IAS/IFRS regulates issues not covered by local standards, on the contrary the study did not find any relation between such reduction and the existing divergence between local standards and IASB standards. The study also finds a positive and significant relation between the reduction of the earnings management and the level of the legal enforcement of each country.

Zeghal, *et al*. (2012) in a study titled, the Effect of Mandatory Adoption of IFRS on Earnings Quality: Evidence from the European Union, addresses the question of whether the mandatory adoption of IFRS is associated with higher accounting quality. Specifically, the study investigate whether the application of IFRS in 15 European Union (EU) countries is associated with less earnings management and higher timeliness, conditional conservatism and value relevance of accounting numbers. The results suggest that there has been some improvement in accounting quality between the pre and post IFRS adoption periods. In particular, the study finds that firms exhibit an increase in the accounting based attributes but a decrease in the market based attributes after the adoption of IFRS in 2005. The findings are more pronounced for the firms in countries where the distance between the pre-existing national GAAP and IFRS is important. However, the study failed to identify any change within firms that have converged their local GAAP toward IFRS before the mandatory transition.

Capkun, *et al*. (2012) in a study titled, Does Adoption of IAS/IFRS Deter Earnings Management, examine whether the transition to IAS/IFRS deters or facilitates greater earnings management (earning smoothing). They argue that IAS/IFRS standards changed dramatically from the early voluntary adoption period to the mandatory adoption year, particularly during the period from 2003 to 2005when the IASB was making compromises to win endorsement of IAS/IFRS standards from EU member countries. They posit that the greater flexibility in IAS/IFRS standards has lead to greater earnings management (income smoothing) under the current IFRS reporting regime. Consistent with this conjecture, they find an increase in earnings management from pre-2005 to post 2005 for early voluntary adopters and late adopters in countries that allowed early IAS/IFRS adoption, and for mandatory adopters in countries that did not allow early adoption.

Rudra (2012) in a study titled, Does IFRs Influence Earnings Management? Evidence from India, examines whether adoption of international standards, is associated with reduced earnings management. Regression model

is used in this firm-level study. The results contradict most of the previous findings based on developed countries by indicating that firms adopting international standards (i.e., International Financial Reporting Standards or IFRS) are more likely to smooth earnings compared to non-adopting firms. These findings could prompt the regulators to think about the effectiveness of IFRS in reducing opportunistic earnings management in an emerging economy.

Capkun, Collins and Jeanjean (2013) in a study titled, the Effect of IAS/IFRS Adoption on Earnings Management (Smoothing): A Closer Look at Competing Explanations, argue that IAS/IFRS changed substantially from the early voluntary adoption period to the mandatory adoption year (2005). Compared to earlier IAS/IFRS and many countries domestic GAAP standards, the study maintains that the IFRS standards that went into effect in 2005 provide greater flexibility of accounting choices because of vague criteria, overt and covert options and subjective estimates that are allowed under these principle based standards. The study further argues that this greater flexibility coupled with the lack of clear guidance on how to implement these new standards has led to greater earnings management (smoothing). Consistent with this view, the study find an increase in earnings management (smoothing) from the pre-2005 to post-2005 for early adopters and late adopters in countries that allowed early IAS/IFRS adoption and for mandatory adopters in countries that did not allow early IFRS adoption.

Major findings of the study hold after eliminating firms more likely to have mechanically-induced increases in earnings smoothing properties as a result of IFRS adoption and across countries with and without concurrent improvements in enforcement of accounting standards. The study also find that firms from countries with less (more) local GAAP flexibility exhibit greater (less) evidence of increases in earnings management following mandatory adoption of IFRS standards in 2005. The results suggest that the increased flexibility of new IAS/IFRS standards and lack of clear guidance in implementing these standards are major factors that explain earnings management changes around IFRS adoption.

Chiha, Trabelsi and Hamza (2013), in a study titled, the Effect of IFRS on Earnings Quality in a European Stock Market: Evidence from France, examines the impact of IFRS adoption on earnings quality for a sample of listed companies in a European stock market: The Paris stock exchange. The empirical study covers the nine-year period from 2002 to 2010. Earnings quality is examined by measuring the strength of the association between earnings and firm market value. Results indicate that accounting information quality has been improved by the increase of the association degree. Earnings measured using IFRS are more useful for firms' evaluation. This result was less evident during the Global Financial Crisis. Further tests indicate that these results are not significantly sensitive to the firm size. Value relevance of earnings prepared using IFRS is not higher for large companies.

Palacio-Manzano and Martinez-Conesa (2014), in a study titled, Assessing the Impact of IFRS Adaptation on Earnings Management: An Emerging Market Perspective, examines whether adaptation of standards to IFRS has converted Mexican GAAP into high quality standards by increasing comparability with US GAAP and reducing earnings management. The study questions, according to Agency Theory, whether the differences between earnings reported by Mexican GAAP and US GAAP may be due to the opportunistic interpretation of Mexican standards by managers, rather than to differences between the accounting standards of both countries.

Pelucio-Grecco, Santostaso-Geron, Begas-Grecco and Cavalcante-Lima (2014) in a study titled, the Effect of IFRS on Earnings Management in Brazilian non-Financial Public Companies, evaluate whether changes in accounting practices brought a reduction in EM in listed Brazilian non-financial companies through discretionary accruals. The study develop a model to observe the effect of the IFRS on firms EM as well as the restrictive effects of the audit, the corporate governance and the regulatory environment. The study finds that the ones with the most limiting effects is the regulatory environment. They also find that the transition to IFRS had a restrictive effect on EM in Brazil after its complete implementation.

Xu (2014) in a study titled, the Effects of IFRS Adoption on Earnings Management: Evidence from the UK Private Firms, examines the effects of adopting IFRS on earnings management of private firms. With a sample of the UK private firms from year 2003 to 2010, the study uses discretionary accruals to detect earnings management based on modified Jones Model. The study also examines that whether effects of IFRS adoption are conditional on audit quality and firm size. The results show that IFRS adoption does not reduce the level of earnings management; on the contrary earnings manipulation is intensified after the adoption of new accounting standards among the UK private firms. The results indicate that higher audit quality does not work as a constraint on earnings manipulation but increases the level of earnings management for IFRS adopters with income-

decreasing earnings management. The study also shows that larger firm size intensifies earnings management for IFRS adopters with income-increasing accruals.

Ismail, Kamarudin, Zijl and Dunstan (2014), in a study titled, Earnings quality and the adoption of IFRS-based accounting standards: Evidence from an emerging market, investigate the differences in earnings quality of Malaysian companies after the adoption of IFRS-based accounting standards named FRS. They hypothesize that under the new set of accounting standards, the quality of earnings reported by these companies is relatively higher. Specifically, the study tests whether the level of earnings management is significantly lower after the adoption of IFRS, and reported earnings is more value relevant during the IFRS period. This study uses a large sample of 4,010 observations over a three-year period before and a three-year period after the adoption of the new set of accounting standards. The results show that IFRS adoption is associated with higher quality of reported earnings. It is found that earnings reported during the period after the adoption of IFRS is associated with lower earnings management and higher value relevant.

Sellami and Fakhfakh (2014), in a study titled, Effect of the Mandatory Adoption of IFRS on Real and Accruals-based Earnings Management: Empirical Evidence From France, examine whether the mandatory IFRS adoption within French listed companies provides higher earnings quality. More precisely, they study the impact of mandatory IFRS adoption on two approaches of earnings management: real and accruals-based earnings management. This study focuses on a sample of 1488 firm-year observations, 124 firms drawn from the 250 French-listed companies during the period from 1999 to 2011. They use the panel data for analysis. Specifically, the FGLS estimator method is conducted on the regression models. Results indicate that the absolute value of discretionary accruals is significantly reduced six years after the mandatory adoption of IFRS. They also find a negative association between the real earnings management and the mandatory adoption of IFRS. They conclude that earnings quality is improved in the post-IFRS period in the French context.

Onalo, Lizam and Kaseri (2014), in a study entitled, the Effects of Changes in Accounting Standards on Earnings Management of Malaysia and Nigeria Banks, investigate the effects of changes from Malaysia and Nigeria previous accounting standards to IFRSs-based standards on earnings management of Malaysia and Nigeria banks. They investigate whether changes in Malaysia and Nigeria accounting standards affects earnings management activities. They use a sample of 23 banks representing 8 Malaysian banks and 15 Nigerian banks for a study period of 4 years (2009-2012). The study uses the modified Jones (1991) model to investigate earnings management in the banking sector. MFRSs and IFRSs impact more significantly and positively on the quality of accounting information of banks than the previous FRSs and SASs respectively for Malaysia and Nigeria. Specifically, the accrual and earnings quality of Nigerian banks has improved by approximately 41% and Malaysia banks 12.6% during the IFRSs/MFRSs adoption era. They recommend that IFRSs should be adopted as the standard for the preparation and reporting of financial statements.

Nairaproject (2014) in a study titled, the Impact of IFRS on the Quality of Financial Statements, examines whether the impact of IFRS in Nigeria has improve the quality of financial reporting in First Bank of Nigeria Plc. The study compares changes in the quality of accounting between the pre adoption period from 1995 to 1999 and the post adoption period from 2000 to 2004. The study tests whether there is less earnings management, more timely loss recognition and higher value relevance in the adoption period as opposed to the pre-adoption period. It also takes a global perspective to the IFRS question in relation to quality. The outcome of the study shows mixed results with some of the metrics indicating a marginal increase in accounting quality and others showing a decrease in the quality of accounting.

Beuren and Klann (2015) in a paper titled, Effects of the Convergence to International Financial Reporting Standards in Earnings Management, identify European countries in which the adoption of IFRS represented greater change in the earnings management levels disclosed by companies. The documentary research was based on Thomson Financial data base, from which were collected the data covering the period from 2000 to 2003 (before the IFRS adoption) and from 2006 to 2009 (after the IFRS adoption), to calculate the frequency distribution of small profits over small losses, as an indicator of earnings management. The research results indicate the existence of three groups of countries: those positively affected by the adoption of IFRS, with a reduction in the level of earnings management; those negatively affected, with increased management; and those which that did not present significant effects or they could not be detected. It was concluded that, despite the higher quality expected with the adoption of the IASB accounting standards, in some countries the effect of IFRS application is not consistent with this expectation in the period analyzed.

3. Methodology

The population of the study is made up of 21 deposit money banks in Nigeria. The sample consists of all the 15 listed deposit money banks on the floor of the Nigerian Stock Exchange. All data were hand-collected from the financial statements of the banks under consideration. To test the hypothesis that IFRS reduces earnings management behaviour of Nigerian deposit money banks, the study adopted existing literature (Ahmed et al., 1999; Laeven and Majnoni, 2003; Liu and Ryan, 2006; Tanko, 2012) and estimate the following model:

$$LLP_{it} = \alpha_0 + \alpha_1 NPL_{it-1} + \alpha_2 \Delta NPL_{it} + \alpha_3 \Delta Loans_{it} + \alpha_4 RegCap_{it-1} + \alpha_5 Ebtllp_{it} + \alpha_6 IFRS + \alpha_7 IFRSEbtllp_{it} + \varepsilon_{it}$$

Where as:

LLP_{it} - current year's loan loss provisions

NPL_{it-1} - the non-performing loans at the beginning of the year

ΔNPL_{it} - the current changes in non-performing loans (NPL_{it} - NPL_{it-1}),

$\Delta Loans_{it}$ - current changes in total loans ($Loans_{it}$ - $Loans_{it-1}$).

$RegCap_{it-1}$ regulatory capital ratio

$Ebtllp_{it}$ - earnings before taxes and loan loss provisions

$IFRS$ - a dummy variable that has the value 1 (0) for IFRS (GAAP)

$IFRSEbtllp_{it}$ - interaction term

ε_{it} – error term

These variables capture the level (NPL_{it-1}) and changes in banks' credit risk (ΔNPL_{it}; $\Delta Loans_{it}$) and are included to control for the non-discretionary portion of loan loss provisions. The study also includes the lagged regulatory capital ratio, $RegCap_{it-1}$, to control for the potential use of loan loss provisions for the purpose of capital management. $Ebtllp_{it}$ is earnings before taxes and loan loss provisions and captures the extent to which banks provide for future expected loss and or manage their earnings before IFRS adoption. Given wide empirical evidence that banks manage earnings through loan loss provisions, the study expects a positive α_5 coefficient. $IFRS$ is a dummy variable that has the value 1 (0) for IFRS (GAAP) bank year observations. The interaction term $IFRSEbtllp_{it}$ is our main variable of interest. If IFRS adoption is effective in reducing earnings management then we should observe a negative α_7 coefficient.

4. Results and Discussion

Table 1 presents descriptive statistics for the dependent and explanatory variables used in the study for the pre-IFRS period.

Table 1: Descriptive statistics of bank-specific variables (period 2004 – 2008)

GAAP	Loans	LLP	NPL	ΔNPL	ΔLoans	RegCap	EBTLLP
Mean	80400	0.007159	0.034366	0.001980	0.101209	0.111	0.014495
Min	8.39	-0.00447	0.000644	-0.17307	-0.59064	0.055	-2.89553
p25	6607.6	0.002882	0.009633	-.001229	0.035827	0.100	0.015706
p50	25182	0.003747	0.022095	0.000676	0.087919	0.110	0.020630
p75	12778	0.008361	0.043351	0.003848	0.149331	0.119	0.027368
Max	47545	0.132050	0.450893	0.166190	1.090760	0.214	0.558419
Sd	11071	0.00999	0.043698	0.017942	0.144066	0.018	0.175435

Source: SPSS Output from Field Data, 2014

Table 2 presents descriptive statistics for the dependent and explanatory variables used in the study for the post-IFRS period.

Table 2: Descriptive statistics of bank-specific variables (period 2009 – 2013)

IFRS	Loans	LLP	NPL	ΔNPL	ΔLoans	RegCap	EBTLLP
Mean	116947	.00486	.03189	.00402	.16649	0.112	0.02572
Min	38.60	-.0079	.00005	-.18917	-.37100	0.075	-.021852
p25	8098.8	.00102	.00808	-.00061	.09273	0.099	.015666
p50	36928.	.00317	.01986	.00106	.14774	0.110	.021077
p75	139776	.00502	.04302	.00472	.22394	0.123	.027131
Max	927673	.09413	.30707	.29078	1.9145	0.195	.580462
Sd	170775	.01019	.03913	.02762	.17912	0.019	.038141

Source: SPSS Output from Field Data, 2014

The comparison of the two periods reveals that the time period is characterized by a boom phase. Specifically, banks experience a significant growth of their loan portfolio, on average, 16.65 % (median 14.77 %) during IFRS period as compared to 10.12 % (8.79 %) before IFRS adoption. Non-performing loans (NPL_{it-1}) remain relatively stable over the whole time period, and represent, on average, 3.44 % (median 2.21 %) of loans before and 3.19 % (median 1.99 %) after IFRS adoption. Regulatory capital ratios ($RegCap_{it}$) remain basically similar in both time periods. Earnings before taxes and loan loss provisions ($EBTLLP_{it}$) increase slightly; however, this increase is statistically not significant. Besides the impressive loan growth the most significant change between the two time periods relates to our dependent variable the level of loan loss provisions (LLP_{it}). LLP_{it} decreases significantly from a mean of 0.72 % (median 0.54 %) to 0.49 % (median 0.32 %) after IFRS adoption. Taken

together, descriptive statistics analysis suggests that although expected credit risk in Nigerian banks' balance sheets increased in the IFRS period, as indicated by significantly higher loan growth, bank managers decreased their loan loss provisions.

This study major contribution lies in the inclusion of non-performing loan as a control variable. Most studies use different specifications; particularly they do not include non-performing loans. By not including non-performing loans, these studies fail to control for a key determinant of loan loss provisions given that the largest part of the loan loss provisions, the specific loan loss provisions, is based on non-performing loans. Laeven and Majnoni (2003) use the change in loans as a proxy for the non-discretionary portion of the loan loss allowance, which is not sufficient to extract the non-discretionary portion of loan loss provisions. Fonseca and Gonzalez (2007) use the beginning level of loan loss allowances as a proxy for the nondiscretionary portion. However, first there is a mechanical accounting relationship between the loan loss provision and loan loss allowance (Wahlen, 1994). Second, because of this relationship, the loan loss allowance comprises significant discretionary portions, which arguably will correlate with other explanatory variables used in the regression, e.g. regulatory capital and earnings before loan loss provisions.

Table 3 presents the results for our earnings management tests. Models (1-5) test the impact of IFRS on the correlation between earnings and loan loss provisions.

Table 3: The effect of IFRS adoption on earnings management through the use of loan loss provisions

Explanatory variables	Coefficients	Predicted signs	Model 1	Model 2	Model 3	Model 4	Model 5
NPL_{it-1}	α_1	+	0.051 (1.98)	0.065 (2.50)	0.051 (2.03)	0.068 (2.73)	0.081 (3.43)
ΔNPL_{it}	α_2	+	0.170 (3.09)	0.183 (3.26)	0.171 (3.10)	0.183 (3.36)	0.193 (3.55)
$\Delta Loans_{it}$	α_3	+	-0.006 (-2.51)	-0.007 (-2.66)	-0.007 (-2.82)	-0.007 (-2.75)	-0.006 (-2.80)
$RegCap_{it-1}$	α_4	?	-0.028 (-0.93)	-0.035 (-1.19)	-0.024 (-0.77)	-0.026 (-0.86)	-0.024 (-0.77)
$Ebtllp_{it}$	α_5	?	0.232 (5.31)	0.279 (4.50)	0.173 (3.13)	0.268 (4.93)	0.161 (2.91)
$IFRS$	α_6	+	0.004 (3.11)	0.004 (2.57)	0.003 (1.93)	0.003 (2.44)	0.004 (3.03)
$IFRSEbtllp_{it}$	α_7	?	-0.228 (-4.97)	-0.293 (-4.44)	-0.182 (-2.55)	-0.272 (-4.86)	-0.395 (-7.12)
R^2			0.369	0.406	0.375	0.415	0.458
Adjusted R^2			0.351	0.385	0.352	0.394	0.431

Source: SPSS Output from Field Data, 2014

Loan loss provisions increase with the beginning level of non-performing loans (NPL_{it-1}) and the current change in non-performing loans, ΔNPL_{it} ($\alpha_1>0$ and $\alpha_2>0$). The coefficient α_3 on loan growth ($\Delta Loans_{it}$) is contrary to our expectations negative and significant. This variable should capture the change in risk inherent in the performing loan portfolio, i.e. loan growth implies increases in risk, and thus we would expect a positive coefficient. However, the result is in line with Laeven and Majnoni (2003), who also find a significantly negative coefficient on loan growth. They posit that the negative coefficient results from the procyclical behaviour of banks.

5. Conclusion and Recommendations

The effects of IFRS adoption have been analyzed in several contexts for non-financial firms in prior literature. This study provides empirical evidence on the accounting quality implications of application of IFRS (IAS 39) within the Nigerian deposit money banking sector. The study predicts and finds that the application of stricter impairment rules reduces discretion in the main operating accrual in banks' accounts, the loan loss provision. Generally, the deposit money banks exhibit significantly less earnings management which is consistent with the theoretical argument of Ewert and Wagenhofer (2005) who show that tighter accounting rules result in less earnings management.

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